Economics focus: second thoughts about globalisation

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Second thoughts about globalisation

Economists are often accused of playing down the costs of global integration, while protectionists deny its benefits. Is there a middle ground? THE debate about globalisation is largely a dialogue of the deaf. On one side, ivory-tower economists tout the benefits of increased trade and cross-border investment, while ignoring (or at least downplaying) the costs. On the other, the critics of freer trade and open capital markets refuse to acknowledge the gains from closer integration, often displaying at best an elementary grasp of economics.

Dani Rodrik, an economist at Harvard University with impeccable mainstream credentials, wants to rectify that. He has waded into the debate with a book* all the more controversial for being published by a think-tank known for its sympathy with the globalisers. Chastising his academic colleagues for their optimism, he aims to provide intellectual rigour for a more sceptical position.

Mr Rodrik’s argument rests on three planks. First, he claims that his academic colleagues underestimate the effect of freer trade and capital flows on the established balance of power between employers and employees. Most economists contend that trade is only a minor cause of increased earnings inequality in America and other rich countries. Mr Rodrik says that this misses the point. Globalisation has made it easier for firms to shift production overseas, substituting foreign workers for local ones. The threat that jobs will go abroad, he suggests, could lie behind job insecurity, the erosion of non-wage benefits and the weakening of trade unions.

His second point is that economists have been too ready to ignore rich-world concerns that globalisation will undermine social norms such as workers’ rights. When, say, South Carolinian workers cry foul at losing their jobs to Honduran children, their complaints are more than mere protectionism. Their idea of “fairness”, and with it popular support for freer trade, is being eroded.

Third, says Mr Rodrik, globalisation makes it increasingly difficult for governments to provide social insurance— which, he says, has mitigated the risks to some workers of freer trade and hence helped to make trade politically acceptable. Before the second world war the share of average government spending in industrial countries was roughly 20% of GDP . Now it is around 47%, and in rich countries spending on social protection is closely correlated with exposure to trade (see). But as capital and skilled labour become more mobile, it will become harder for governments to raise the taxes to finance social spending.

Coming from an economist of Mr Rodrik's standing, this is provocative stuff. But is it right? Granted, Mr Rodrik is correct to point out areas where economic research has been lacking: too much time has been spent poring over the statistical link between trade and wages, for example, and not enough on the broader effects of trade on labour markets. Other parts of his argument are much weaker.

Take the rise of the welfare state. His contention that trade lies behind the rise in social spending is dubious: in both America and Europe, it was in large part a political response to the depression of the 1930s—which was itself worsened by increased protection. Moreover, if social spending is intended as insurance against the supposed risks of freer trade, it is hard to see why in many countries such a big slice of it goes to pensioners, who gain from lower import prices but do not have jobs to lose.

Worse, obsessed with the idea that globalisation threatens the social contract in rich countries, Mr Rodrik almost forgets that both rich and poor countries stand to benefit enormously from trade. Thus the question in the rich world is not whether there are gains to be made (there are) or whether some people will lose (they will), but how the gains from trade are shared out. And how did Americans and Europeans come to see trade-union rights, bans on child labour and so forth as "fair", if not by getting rich enough to afford them? Without trade, perhaps the most important engine of growth in poorer countries, workers in developing countries stand little chance of ever doing the same. Paying too much attention to rich-world worries about differences in social norms runs the risk of perpetuating them.

And the alternative

Insisting that prescription is not the main purpose of his book, Mr Rodrik offers few policies to limit the costs of globalisation. And those are likely to do more harm than good. He suggests, for instance, broadening the World Trade Organisation's rules on "safeguards" against sudden surges in imports. His proposal is to allow countries to impose protection if there is "broad domestic support" that imports are causing social disruption. Such support would be gauged by compelling a country to gather testimony from all relevant parties. But this could easily be abused. Would consumers' voices really be heard above producers' cries for help?

Or take his idea of a global tax on physical capital, intended to reduce the international mobility of employers. This would make investment less profitable, so harming economic growth. And why should poor countries, which crave foreign direct investment, sign up?

The point is not that a Panglossian view of globalisation is justified: there are certainly costs. Rather, it is that the protection of workers in rich countries, although it may be politically tempting, is an economic mistake—however it is dressed up.

Has Globalisation Gone Too Far Institute for International Economics, Washington, DC. March 1997.